



Monetary Policy Efficacy in Inflation Governance: Verification After India's Flexible Inflation- Targeting Regime

Aakash

Ph.D. Research Scholar, Department of Economics, Kurukshetra University, Kurukshetra,
Haryana

Abstract: Persistent inflation erodes purchasing power, creates uncertainty about economic decisions, distorts consumption choices over time and creates welfare losses. The poor get hit the hardest. The Reserve Bank of India (RBI) has adopted the flexible inflation-targeting (FIT) framework in the Indian context to strike a balance between price stability, economic growth and the health of the financial sector. The paper evaluates the effectiveness of monetary policy instruments, particularly the policy repo rate, in influencing the trend of consumer price inflation in the post-FIT period. The study is descriptive analytic and based on secondary data collected from the RBI, the Ministry of Statistics and Program Implementation, the International Monetary Fund (IMF) and related institutional archives for the fiscal years 2015-16 to 2023-24. It covers the MPC's operational journey, Covid-19 pandemic macroeconomic shocks, an inflation surge and the controlled monetary tightening cycle of 2022-23. The empirical framework is based on descriptive statistics, trend decomposition, comparative benchmarking and exploratory correlation analysis. Research has indicated that the average headline inflation over the research period was 5.0 per cent and peaked at 6.7 per cent in 2022-23. Between May 2022 and February 2023, the RBI had responded by raising the repo rate cumulatively by 250 bps, which helped bring down inflation to 5.4 per cent in 2023-24. The disinflation was largely a consequence of the disinflationary dynamics set in motion by the monetary policy tightening. These dynamics included the fall in aggregate demand and the anchoring of expectations. In contrast, the significance of the interest rate approach has been undermined due to structural constraints. Some of these are the unpredictability of the food supply, dependence on energy imports, disruptions caused by climate change, fluctuations in the prices of foreign commodities and logistical hurdles. The results of the study show that the contribution of monetary policy will be to maintain price stability but will not be enough. The integrated macroeconomic stabilization strategy will be centered on fiscal discipline, attempts to enhance agricultural efficiency, energy security, shifts in trade policy and supply chain modernization.

Keywords: Monetary Policy Transmission, Inflation Targeting, Repo Rate, Consumer Price Index, Reserve Bank of India, Monetary Policy Committee, India, Supply-Side Inflation.

1. Introduction

Inflation was one of the primary concerns of macroeconomic management at this time. The prices of goods and services are expected to continue to go up in the future and the buying power of paper money is expected to continue to go down. Macroeconomic stability would be undermined, relative pricing distorted, real wages reduced, a regressive transfer of income created, and firm confidence reduced (Woodford, 2003). Low inflation can coincide with a healthy economy, but high or unpredictable inflation is likely to undermine business confidence. Getting inflation wrong is very costly in developing countries. They have large informal sectors and most of their spending is on necessities.

A Case Study from India. The influence of demand-side variables, the disturbances on the cost side and the supply-side constraints in some of the localities make it difficult to understand the dynamics of inflation in the country. In particular, the energy and food sectors still profoundly impact on the patterns of household consumption. The agriculture sector is totally dependent on the monsoon, as storage and distribution systems are not functional. India is highly dependent on energy imports and hence prices locally are dictated by the vagaries of the international market for crude oil and other commodities. Presently, the Indian economy is facing problems with the demand as well as supply side. These are the inflationary forces that are making it hard for the central bank to keep the economy on an even keel.

The main instrument of demand management for the objective of controlling inflation is the monetary policy of the Reserve Bank of India. The central bank has a toolkit available to it that it can use to affect monetary and financial conditions to achieve the statutory goals it has set for itself. Instruments in this category include the policy repo rate, liquidity management instruments, reserve requirements, open market operations and forward guidance instruments. The Monetary Policy Committee was constituted with six members in 2016, and the FIT model design brought a significant change in the basic framework of Indian monetary policy. This regime is tied to the consumer price index (CPI), one of the main inflation measures. The medium-term objective is 4 per cent with a tolerance band of ± 2 percentage points symmetrically around the objective.

But it was the pandemic of the COVID-19 virus and its aftermath that made the significance of all this institutional development most manifest. “The Reserve Bank of India (RBI) was very accommodative in terms of the unprecedented slowdown in GDP growth. This was to make sure that credit was available and to spur demand in the economy. That is why repo rates were lowered to record lows. But inflation has come roaring back, with supply chain disruptions, rising global commodity prices and geopolitical upheaval all playing havoc with energy markets. The Reserve Bank of India (RBI) has tightened monetary policy between May 2022 and February 2023, increasing the policy repo rate by 250 basis points. Monetary tightening provides a natural experiment to empirically test the effectiveness of interest rate policy in an emerging market setting, constrained by structural supply-side constraints.

The study is significant in three different ways from both theoretical and policy perspectives. First, it contributes to the extant empirical literature on monetary policy transmission in developing countries. These are countries in which the interest rate channel may be impaired by structural supply rigidities and friction in the financial market. The second part of the paper provides an empirical analysis of the FIT framework in India in periods of high macroeconomic volatility. The objective of this review is to add to the debate on how best to change inflation targets in emerging commodity-importing economies. First, it is an all-encompassing approach in analyzing the relative importance of demand-side and supply-side forces in the upward movement of inflation in India in recent times. The results of the present study give some insight that can be used in the development of concerted measures for the stabilization of the situation.

2. Institutional Evolution of Monetary Policy in India

Monetary policy is the method by which the monetary authority of a country, normally the central bank, controls the supply of money, availability of credit and the rate of interest, to attain a set of objectives oriented toward the growth and stability of the economy. The Reserve Bank of India (RBI) has always been entrusted with the responsibility of achieving a set of objectives that are sometimes at cross-purposes with each other. Its objectives include maintaining price stability, sustaining sound economic conditions, ensuring adequate liquidity in the system and maintaining financial stability. But changes in economic theory, as well as changes in the macroeconomic environment and institutional change, have redefined the relative importance of these objectives.

The new FIT framework is a marked departure from the previous multi-indicator approach, which lacked a clear nominal anchor and often resulted in policy uncertainty. The main determinant of the monetary policy response function for a FIT is the Consumer Price Index (CPI) inflation. Central banks do not have to respond mechanically to short-term supply shocks, such as bad weather or a jump in global oil prices that temporarily lifts inflation above the target range. This flexibility reflects the fact that central banks are not required to. Policymakers hope to reach their goal by stopping the secondary effects of such shocks from disturbing expectations of medium-term inflation.

The Reserve Bank of India (RBI) Act was amended in 2016 to constitute a six-member Monetary Policy Committee. Out of these members, three were chosen by the national government and the other three were proposed by the RBI. The release of minutes, individual member voting and explanations of macroeconomics have helped the committee-based decision-making process to improve the quality of discussions of monetary policy, provide a defense against the possibility of political pressure interfering with technical judgment and increase transparency. These benefits have been achieved through the application of the committee-based decision-making process. Acceptance of the disagreements between MPC members and of a wide range of analytical perspectives has been the basis for establishing the legitimacy of the inflation goal. This is an important part of managing expectations effectively.

3. Inflation: Formulation and Assessment

Inflation is typically defined as a sustained increase in the general price level in the economy. This leads to a decrease in the real value of money. In the Indian setting, the episodes of inflation can be grouped into a few analytically different categories:

3.1 Demand-pull inflation

This happens when the total demand is greater than the economy's ability to produce at current prices. Expenditure increases, credit-fueled consumption booms, investment booms, or positive wealth effects can generate excessive demand pressures and generalized price inflation.

3.2 Inflationary Trends

Cost-push phenomena are initiated by supply-side factors such as rising costs of production inputs (labor, energy costs, transportation fees, imported intermediate products, and raw materials). No matter what demand is like, the price level goes up as companies pass these increases on to customers.

3.3 Increasing Food Prices

In India, food expenditure is a large part of a family's expenditure and so changes in the prices of agricultural commodities have a disproportionate effect on overall inflation. Fluctuations in yields can be caused by shortfalls in precipitation, pest outbreaks, or deviations in temperature; inadequate cold storage and storage facilities can lead to post-harvest losses; and limitations in the distribution network can all influence the volatility of food prices, making them somewhat less susceptible to standard monetary policy instruments.

3.4 Inflation imported

India imports more crude petroleum and other industrial commodities than it exports and therefore responds to international price movements and exchange rate fluctuations. A rupee depreciation or a rise in global energy prices conveys inflationary impulses directly through higher domestic fuel prices and indirectly through higher transportation and manufacturing prices.

3.5 Underlying inflation

Core inflation strips out the volatile food and energy components of the price basket and is therefore intended to measure the underlying or trend inflation dynamics. This measure is especially useful to monetary policymakers as it strips out temporary supply shocks and highlights persistent inflation pressures that are best tackled through interest rate policy.

3.6 Measuring Framework

The official measure of inflation for India's FIT framework is the all-India combined CPI compiled by the Ministry of Statistics and Program Implementation (MoSPI). The index breaks consumption into rural, urban and composite baskets. Data is available on a monthly and annual basis since January 2015. The Wholesale Price Index (WPI) continues to be published but has

been superseded by the CPI for the purposes of monetary policy, as the latter is more representative of the cost-of-living experiences of households and the inflation expectations formed by them.

4. Theoretical Framework

The research is in the New Keynesian tradition in monetary economics where nominal rigidities, forward-looking expectations and systematic central bank responses to macroeconomic shocks play a central role (Clarida et al., 1999). The analysis is based on the monetary transmission mechanism, which means that the policy measures of the central bank filter through the economy through various interlinked channels.

The inflation mechanism can be described schematically as:

where current inflation is, where the output gap is, where expected future inflation is, and contains external supply-side shocks. The influence of monetary policy on inflation is mainly through three channels:

- (1) adjusting the output gap by controlling aggregate demand;
- (2) adjusting financial conditions through the interest rate channel and credit channel; and
- (3) anchoring expectations through credible forward guidance and consistent policy actions.

An increase in the policy repo rate increases the marginal cost of financing in the financial system. This means more expensive borrowing and deposits for commercial banks. The resulting increase in the user cost of capital decreases interest rate-sensitive consumption and investment and therefore decreases aggregate demand and the output gap. At the same time, a credible commitment to the inflation target will anchor the expectations of households and firms and prevent transitory changes in prices from becoming embedded in wage and price setting.

But theoretical literature does acknowledge some limits to the effectiveness of monetary policy. When inflation is mainly caused by shortfalls in agricultural supplies or increases in international commodity prices, the interest rate mechanism does not have much effect in directly increasing food output or affecting world energy markets. In such circumstances, monetary tightening may bear with it costs in terms of output and jobs, with few or no short-term gains in disinflation. Showing the need for more supply-side action.

5. Review of Literature

5.1 Theoretical Foundations of Monetary Policy and Inflation

The academic tradition linking the conduct of monetary policy to price stability is based on seminal work emphasizing the significance of institutionalized policy regimes and management of expectations. Central banks that follow systematic feedback rules and respond strongly to deviations of inflation and output from target are more successful in macroeconomic stabilization than discretionary central banks (Taylor, 1993). Clarida et al. (1999) extend this framework by using a New Keynesian dynamic stochastic general equilibrium model. They assumed that expectations of future policy actions were important for inflation, as were current policy actions.

Bernanke and Gertler (1995) augmented the transmission framework to include the credit channel and showed that monetary policy affects not only the traditional interest rate channel but also the cost of external finance and collateral valuation. Mishkin (2007) stressed the importance of expectations and financial market mechanisms for the implementation of modern monetary policy and argued that central bank communication and credibility are separate policy instruments.

5.2 Monetary Policy in Emerging Market Economies

The monetary systems of developed economies cannot be transferred directly to developing countries with special problems. In such cases, inflation is typically driven by exchange rate pass-through, volatility of international commodity prices, risks from fiscal dominance and structural supply constraints (Mishkin, 2007). Thin bond markets, heterogeneous bank balance sheets and underdeveloped financial markets may constrain the effective transmission of signals from the policy rate to retail lending rates, increasing transmission lags and reducing the effectiveness of policy.

5.3 Advantages and Disadvantages of Inflation Targeting

In the 1990s, inflation targeting emerged as the dominant monetary policy framework, which is distinguished by its transparency, accountability and ability to anchor expectations (Woodford, 2003). In practice, however, the system has problems when inflation is mainly supply-driven. This problem is particularly important for food- and energy-importing countries and requires central banks to strike a balance between the need to allow transitory price movements to pass through and the need to act forcefully to prevent destabilization of expectations to avoid unnecessary output losses.

5.4 Empirical Evidence from India

The in-house research work of RBI has given important insights on monetary transmission, formation of inflation expectations and macro-economic effects of changes in policy rates. The four variables used in the vector autoregression (VAR) of RBI (2023) are real GDP growth, core CPI inflation, gross budget deficit of the central government and policy interest rate. The study finds that output and inflation respond statistically significantly to changes in monetary policy. Results showed that an increase of the policy rate by 100 basis points would lead to a reduction in GDP growth of about 30 basis points at the peak of the effect, with the effects being felt over several quarters.

“Despite the challenges of volatile food prices, the FIT framework in India has been effective in anchoring inflation expectations and improving macroeconomic stability,” the IMF (2025) has found. The Fund’s 2024 Article IV consultation concluded that the headline CPI is the appropriate target, given the risk that food price volatility could have spillover effects on broader price behavior and expectations.

6. Research Gap

The existing literature on Indian monetary policy is growing, but the present study was motivated by some analytical gaps. Much of the existing work is mainly concerned with formal econometric modeling of transmission mechanisms, with relatively little attention paid to the link between policy-rate cycles and the underlying supply-side determinants of inflation. Second, the COVID-19 pandemic and the subsequent inflationary period of 2022-23 provide an extraordinary natural experiment of a shift from expansive monetary easing to rapid tightening that calls for detailed descriptive and analytical recording. Third, Indian macroeconomic data have the feature of a sparse annual sample. This makes causal inference more difficult and calls for cautious interpretation of reduced-form correlations, institutional and narrative evidence. This study attempts to fill these gaps through historical trend analysis, descriptive statistics, policy timelines and empirical studies by central banks for a comprehensive assessment of the effectiveness of monetary policy during a tumultuous decade.

6. Methodology

6.1 Research Design

The research method is descriptive-analytical. The descriptive section records trends in inflation, interest rates and macroeconomic conditions in a systematic way. The analytical section explores correlational patterns and explains key policy events through narrative and comparative techniques.

6.2 Data Sources and Nature

The investigation relies exclusively on secondary data extracted from authoritative institutional repositories:

- Reserve Bank of India (policy rates, monetary policy reports, annual reports, database on Indian economy);
- Ministry of Statistics and Programme Implementation (CPI inflation statistics);
- International Monetary Fund (Article IV consultation reports, macroeconomic assessments);
- World Bank (World Development Indicators).

6.3 Study Period

The main period of analysis is the fiscal years 2015-16 to 2023-24. This nine-year period comprises (i) the development of the MPC and FIT framework, (ii) macroeconomic turbulence from the COVID-19 pandemic, (iii) inflationary spike post-pandemic, (iv) the tight tightening of 2022- 23, and (v) the subsequent disinflationary period of 2023-24.

6.4 Variables

The dependent variable is the headline CPI inflation rate (in percent). The main independent variable is the policy repurchase rate (%). The other explanatory variables considered in the narrative analysis are food price movements, international crude oil prices, foreign exchange rate movements, global commodity price indices, supply chain disruption indicators and fiscal situations.

6.5 Analytical Techniques

The empirical apparatus comprises:

1. Frequency distributions and percentage analysis;
2. Central tendency and dispersion measures (mean, median, standard deviation);
3. Minimum and maximum value identification;
4. Trend analysis and graphical decomposition;
5. Comparative cross-period benchmarking;
6. Pearson product-moment correlation analysis;
7. Policy event analysis and narrative evaluation.

The study acknowledges that robust causal identification would require higher-frequency (monthly or quarterly) time-series econometrics, specifically VAR, structural VAR, or autoregressive distributed lag (ARDL) frameworks capable of modeling dynamic interactions, endogeneity, and transmission lags.

7. Trend Analysis of Inflation in India

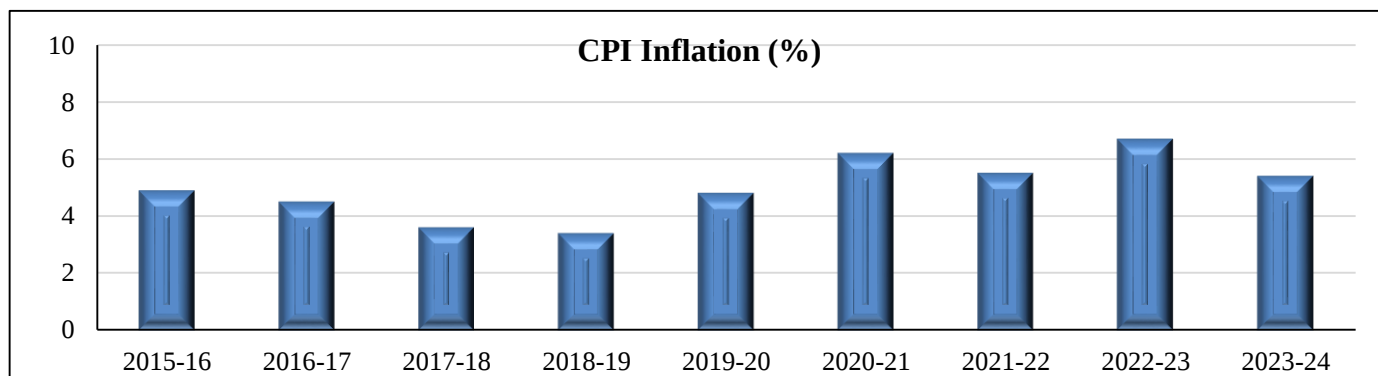
Table 1: CPI Inflation in India, 2015-16 to 2023-24

Financial Year	CPI Inflation (%)
2015-16	4.9
2016-17	4.5
2017-18	3.6
2018-19	3.4
2019-20	4.8
2020-21	6.2
2021-22	5.5
2022-23	6.7
2023-24	5.4

Note. Compiled from official CPI series maintained by MoSPI and RBI. Values represent rounded annual averages.

The trend of the Consumer Price Index (CPI) in the sample period on an annual basis is illustrated in Table 1. The results indicate a clear trajectory of moderation followed by intensification. Inflation eased gradually from 4.9 percent in 2015-16 to a low of 3.4 percent in 2018-19, aided by positive base effects, lower international commodity prices and relatively tight monetary conditions in the immediate post-FIT transition. This fall happened during the transition period from FIT to FIT. This trend began to reverse in the year 2019-20 and during the pandemic, inflation shot up to 6.2 percent in the year 2020-21.

After a marginal fall to 5.5 per cent in 2021-22, inflation rose to an all-time high of 6.7 per cent in 2022-23 in the research period. This led to inflation going beyond the upper limit of the acceptable range under the FIT framework, incurring high



political and welfare costs. There was a further fall to 5.4 per cent in 2023-24, in tandem with the tightening cycle and the reduction of international commodity pressures. But food price volatility remained substantial.

Figure 1: CPI Inflation in India, 2015-16 to 2023-24

8. Monetary Policy Stance and Repo Rate Trajectory

Table 2: Selected Policy Repo Rate Conditions, 2015-16 to 2023-24

Financial Year	Representative Repo Rate (%)	Broad Policy Characterization
2015-16	6.75	Moderately restrictive
2016-17	6.25	Gradual easing
2017-18	6.00	Neutral to accommodative
2018-19	6.50	Calibrated tightening
2019-20	5.15	Accommodative easing
2020-21	4.00	Highly accommodative
2021-22	4.00	Sustained accommodation
2022-23	6.50	Aggressive tightening
2023-24	6.50	Restrictive stance maintained

Note. Observations represent representative policy rates rather than annual averages, given intra-year adjustments. The repo rate changed multiple times during 2019-20 and 2022-23.

Table 2 presents a brief evaluation of the movement of the policy repo rate and the relevant description of the monetary policy existing in the economy. The policy space was marked by a major turning point in the 2022-23 period, when the Monetary Policy Committee (MPC) approved six consecutive hikes in interest rates. This hike in rates led to an immediate increase in the repo rate from 4.00 percent to 6.50 percent, reducing accommodation by 250 basis points. This led to the sharpest tightening of monetary policy over a decade, ostensibly to prevent inflation expectations from un-anchoring and to restore price stability to a tolerable degree.

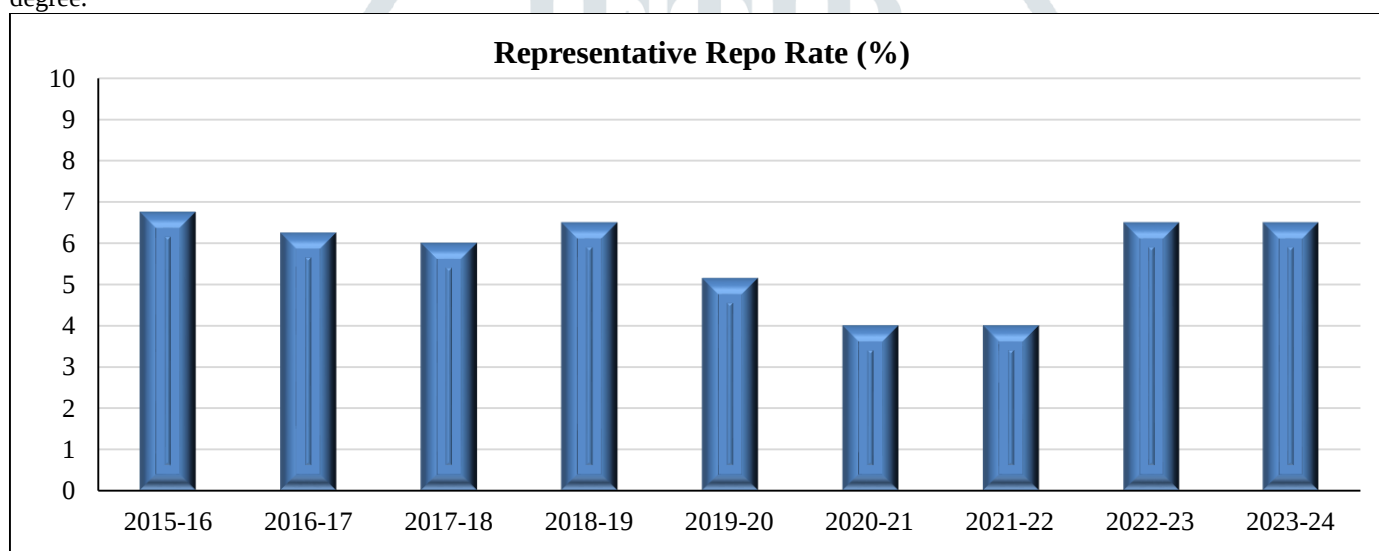


Figure 2: Repo Rate Conditions, 2015-16 to 2023-24

9. Descriptive Statistics

Table 3: Descriptive Statistics for CPI Inflation and Representative Repo Rate

Statistic	CPI Inflation (%)	Repo Rate (%)
N	9	9
Mean	5.00	5.71
Median	4.90	6.25
Standard Deviation	1.09	1.06
Minimum	3.40	4.00
Maximum	6.70	6.50

Univariate descriptive data for the two main variables are shown in Table 3. The average inflation rate of 5.00 percent is higher than the 4 percent medium-term objective, implying a continuously higher trend in the price level during the FIT period. The standard deviation of 1.09 percentage points suggests significant year-to-year volatility, which was heavily affected by the epidemic and the supply disruptions that followed. The average representative rate was 5.71 percent, ranging from the 4.00 percent low set during the epidemic to the 6.50 percent high after monetary tightening.

10. Correlation Analysis

Table 4: Pearson Correlation Between CPI Inflation and Representative Repo Rate

Variables	Correlation (r)	Interpretation
CPI Inflation ↔ Repo Rate	-0.007	Negligible contemporaneous linear association

Table 4. Pearson correlation coefficient between CPI inflation and representative repo rate. The correlation coefficient of about -0.007 indicates that there is almost no linear relationship between the two variables in the same year. This result should therefore be taken with caution and not as an indication of the irrelevance of monetary policy. Such a conclusion is prevented by several econometric and institutional factors.

In the first period, monetary policy is endogenous, with the RBI adjusting the repo rate to respond to current or expected deviations of inflation. So simple bivariate correlations are confounded by reverse causality. Second, monetary policy operates with long and variable lags. The empirical evidence for India suggests that transmission lags for production are of the order of three to four quarters, and possibly longer for inflation.

All these various effects are always buried in the annual concurrent assessments. Third, the annual numbers combine the intra-year variations and therefore mask the timing and sequencing of policy actions relative to turning points in inflation. Fourth, inflation volatility coming from supply shocks (for example, weather surprises, energy price spikes, and supply chain disruptions) is orthogonal to monetary conditions. Thus, the almost non-existent link is not a sign of ineffectiveness of the monetary policy but rather the statistical limitations of the analytical model lack economic terms.

11. Monetary Policy Easing and the COVID-19 Crisis

The Covid-19 pandemic was an external macro-economic shock of unprecedented proportions, disrupting supply chains, limiting aggregate demand and generating uncertainty, the like of which has never been seen before. The Reserve Bank of India (RBI) announced a full set of support measures, including rate cuts, special long-term repo operations to provide liquidity, regulatory forbearance and forward guidance, which will continue to be backed by the RBI.

The repo rate has been lowered to 4.00 percent, which is the lowest rate ever in the history of modern monetary policy. There was a lenient approach in the years 2020-21 and 2021-22 as a means of providing assistance to the economic recovery. This episode throws the spotlight on the basic problems that inflation-targeting central banks face when confronted with big downturns. If tightening comes early, it may raise unemployment and cause losses in output; if accommodation lasts long, the ability to cope with future inflation may be impaired if supply constraints become tighter. The operational flexibility built into the FIT framework is reflected in one example: the gradual transition the Reserve Bank of India (RBI) will make in 2022.

12. The inflationary phase and subsequent monetary contraction of 2022-23

Table 5: Major Repo Rate Adjustments During the 2022-23 Tightening Cycle

Policy Period	Repo Rate (%)
Early 2022	4.00
May 2022	4.40
June 2022	4.90
August 2022	5.40
September 2022	5.90
December 2022	6.25
February 2023	6.50

In 2022, the inflationary environment worsened on the back of a cocktail of negative developments including spikes in global commodity prices arising from geopolitical tensions, high energy prices, rising domestic food prices, supply chain disruptions and strong post-pandemic demand. Headline inflation crossed the 6 per cent tolerance limit and put at risk the stability of inflation expectations anchored at 4 per cent. RBI began a pre-emptive and calibrated process of tightening. The stages are outlined in Table 5.

The repo rate has been returned to 6.50 per cent, a level last seen during the pre-pandemic era, with a total adjustment of 250 basis points. The MPC stated that this tightening was necessary to avoid generalized inflationary pressures and to ensure that inflation converges gradually to the target. This view found econometric support in the RBI's own internal VAR analysis, which documented statistically significant inflation responses to identified monetary policy shocks.

13. Inflation Moderation During 2023-24

Table 6: Selected Inflation and Policy Indicators: 2022-23 versus 2023-24

Indicator	2022-23	2023-24	Direction
Headline CPI inflation	6.7%	5.4%	Declined
Monetary policy stance	Tightening	Rate maintained	Consolidation
Food price pressure	Elevated	Continued volatility	Persistent
Core inflation	High	Moderated	Declined

A noticeable disinflation followed the contractionary phase. Table 6. Comparison of some variables of the two financial years. Headline inflation fell from 6.7 percent to 5.4 percent, and core inflation slowed sharply, consistent with the demand compression and expectations anchoring effects of monetary tightening. But the continuing oscillations in food prices suggest that inflation was not driven solely by demand, but supply-side rigidities continued to exert price pressures resistant to interest rate actions.

14. RBI's Data on Monetary Transmission:

The descriptive analysis carried out in this research is less advanced than the empirical analysis carried out by the RBI. The four-variable VAR model with real GDP growth, core CPI inflation (excluding food and fuel), gross fiscal deficit of the central government as a ratio to GDP and the policy interest rate was estimated using quarterly data from Q1 1998-99 to Q4 2021-22 with suitable adjustments for the impact of COVID-19.

The examination yielded some results pertinent to this investigation. The responses of production and inflation to monetary policy shocks were statistically significant and thus confirmed the existence of a transmission mechanism in the Indian economy. Second, at its peak impact, a one-percentage-point increase in the policy rate was estimated to lower growth in real GDP by about 30 basis points, with effects distributed over several quarters. Third, inflation reacted with a lag but in a large magnitude to interest rate changes, consistent with the standard view that prices are less responsive than output to monetary shocks.

Evidence suggests that simple contemporaneous correlation analysis is not sufficient for evaluating the effectiveness of monetary policy. The structural econometric technique employed by the RBI can handle endogeneity, dynamics and multi-variable interactions in a way that descriptive statistics cannot replicate.

15. Transmission of India's monetary policy in the economy

In India, monetary policy is transmitted through several channels, which, though independent of each other, are interlinked:

15.1 Interest Rate Channel

Changes in the policy repo rate are associated with changes in money market rates, and to varying degrees, bank lending and deposit rates. Higher rates on retail loans make it more costly for households and businesses to access credit, which in turn dampens their appetite for spending and investing.

15.2. Transmission Mechanism for Financial Information

The amount of credit available is affected by both a contraction of the monetary supply and the cost of goods and services. If interest rates go up, the contractionary impacts could be much more severe. Banks might raise their lending standards, become less inclined to take risks, and reduce the amount of money they lend to borrowers with lower creditworthiness.

15.3 Channel of Anticipations.

Inflation is a credible goal, and the central bank is predictable in its behavior. Therefore, the expectations of economic agents about inflation are affected. The belief that the Reserve Bank of India (RBI) would bring inflation back to 4 percent in the medium run makes agents less likely to embark on self-perpetuating wage-price spirals in response to transitory price shocks.

15.4 Exchange Rate Mechanism

The changes in interest rates between developing countries and developed economies impact the value of the rupee and the movement of capital. The effect is somewhat mitigated by global risk appetite and local growth prospects, but a more restrictive monetary policy could improve the attractiveness of portfolio investments and strengthen the currency, reducing domestic costs of imports. But in some cases, the effect is limited.

15.5 Asset Valuation Corridor

The value assessments are influenced by the monetary conditions of the stock, bond, and property markets. In addition, contraction leads to a decrease in asset prices, which has a negative effect on consumption and investment. That is why Reduction in wealth effects collateral value.

16. Structural Constraints on the Effectiveness of Monetary Policy

16.1 Food price inflation and supply constraints

Structural constraints, the biggest of which is food inflation, pose the most serious impediment to India's fight against inflation. The production and distribution of food products is impacted by the effects of climate change, the price of inputs, the lack of proper storage, and the breakdown of the market. The proposed rate cannot directly induce an increase in output of vegetables or establishment of cold chain facilities or improvement in agricultural logistics. Changes in food prices could therefore make headline inflation trends relatively resistant to the effects of interest rate policies. The International Monetary Fund (IMF) believes that targeting the headline Consumer Price Index (CPI) is okay for India, but only without accompanying measures. This perspective considers the possibility that rising food prices might affect wage expectations and core inflation.

16.2 Impacts of Import-Induced Energy Dependence and Inflation

India's dependence on imported crude oil makes the domestic pricing of oil vulnerable to shifts in global market conditions and currency exchange rates. A rise in the price of oil around the world ripples through transportation, electricity, fertilizer and industrial industries. This leads to cost-push inflation, which monetary policy cannot respond to immediately. This dependence demands a multi-pronged plan including investments in energy transition, strategic petroleum reserves, efficiency improvements and traditional demand management.

16.3 The Need for Finding That Balance Between Growth and Inflation

Costs are involved in the generation of intense monetary constraints that cannot be avoided to control inflation. Higher interest rates discourage private investment, increase the cost of servicing loans, lower the demand for housing, and dampen consumer spending on durable goods. Further, this trade-off is also evidenced by the VAR estimates of the Reserve Bank of India (RBI), which suggest that disinflation comes at the cost of a temporary slowdown in GDP. India's FIT framework implicitly acknowledges this dilemma by implicitly acknowledging that policy leniency can be permitted on a short-term basis in situations when developmental factors justify such leniency.

17. Discussion

The empirical evidence gathered in the present study supports a nuanced assessment of the effectiveness of monetary policy in India. In the first few years after the FIT, inflation was relatively low, permitting a neutral to accommodative monetary policy stance. The COVID-19 crisis required extraordinary measures and the repo rate had been kept at 4.00 per cent for financial stability and to help the economy to recover.

What was needed was a strong economic response to the inflationary spike of 2022-23. We saw real disinflation in 2023-24 following 250 basis points of tightening, with headline and core inflation falling. This tightening and disinflation sequence with the usual transmission lag is consistent with theory and the RBI's structural econometric data.

The obvious difference between this account and the almost non-existent contemporaneous link referred to in section 12 can easily be explained by the problems of identification. The connection between monetary policy and the inflation process is always there, because the reason why rates go up is that inflation goes up, but the disinflationary effects are delayed. In elementary correlation analysis, these fluid causal relations are reduced to a fixed simultaneous measure, and this reveals less than it conceals.

Also, good policy analysis requires looking at the decomposition of inflation into demand-driven and supply-driven components. The persistence of food price volatility in 2023-24, despite the presence of tight monetary policies, suggests that supply-side factors play a major role in the inflation trends in India. Monetary policy is effective in the long run against economy-wide inflation driven by excess demand, but not very effective in the short run against sector-specific inflation driven by supply conditions. The correct conclusion is not that monetary policy does not work, but that it has limits and should be complemented by structural measures.

18. Major Findings

The study shows that the Consumer Price Index (CPI) inflation in India over the period 2015-16 to 2023-24 has been highly volatile, with an average inflation rate of about 5.0 percent per year and a range from 3.4 percent to 6.7 percent per year. A host of factors caused inflation to rise during the pandemic and in the years that followed, including supply chain disruptions, higher food prices, volatile energy prices and general economic uncertainty. Inflation was relatively low during 2017-2018 and 2018-2019. The research conducted under the umbrella of Flexible Inflation Targeting (FIT) faced a major roadblock in the form of an inflation rate of 6.7 percent in the years 2022-23. The Reserve Bank of India (RBI) undertook major changes in monetary policy and increased the repo rate cumulatively by 250 basis points between May 2022 and February 2023, owing to continued

inflationary pressures. Consequently, the inflation rate went down to 5.4 percent in the fiscal year 2023-24. However, core inflation declined more steeply than food inflation, which remained high. It was found that there wasn't much of a link between inflation and the annual benchmark repo rate. This is not to say that monetary policy has failed. The link that has been demonstrated is driven by endogeneity of policy, transmission delays and supply shocks.

The results of the VAR analysis give stronger evidence that a monetary transmission mechanism is statistically significant. The government's move to increase the policy rate will eventually lead to lower output and inflation. The study finds that food inflation and high prices of imported energy are a key structural constraint on the effectiveness of traditional interest rate policy, as these are supply-side issues that cannot be fully countered by monetary tightening. These are supply-side issues. The expected rate of inflation is the main transmission channel of monetary policy. Conditions necessary for the development of these characteristics are credibility of the central bank, consistency of its policy measures and clarity of its statements. The statistics point to the occurrence of this development, indicating an increase in the institutional credibility and efficiency of monetary policy when compared to India's flexible inflation regime. Supply shocks continue to occur both domestically and internationally, but the targeting framework is unable to stabilize prices. To bring inflation under control in the medium term, there is a need for a comprehensive policy framework including monetary policy and appropriate policies in the areas of agriculture, energy, commerce and supply chain management.

19. Recommendations for Policy

19.1 Maintain Credibility of Inflation Target

The Reserve Bank of India (RBI) should remain vigilant on the medium-term Consumer Price Index (CPI) inflation target of 4 per cent and use the headroom available under the Flexible Inflation Targeting (FIT) framework judiciously. Monetary policy must be able to distinguish between temporary and chronic inflationary pressures. Supply disruptions, especially in food and energy, could cause a temporary deviation of inflation from the target. And you can absorb shocks, at least temporary shocks. The right policies should address prolonged inflation pressures. A well-designed inflation targeting framework is crucial for anchoring inflation expectations, building public confidence and ensuring long-run macroeconomic stability.

19.2 Enhancing the robustness of the food supply chains

A holistic strategy to check inflation should include making the food supply chain in India more sustainable. The government should increase spending on agricultural production, irrigation infrastructure, cold storage, warehousing, rural transport and logistics infrastructure. More integrated agricultural markets can assist bridge the supply gap by enabling the movement of food items from excess to deficit areas. Such structural steps can help to lower the frequency and amplitude of food price shocks which have historically been a major source of volatility in India's overall CPI inflation. This would enable monetary policy to respond to inflationary pressures arising from supply-side constraints via an improvement of storage and distribution networks.

19.3 Improve Monetary Transmission

The improvement in the transmission of monetary policy can make RBI's policy measures more effective. Structural reforms that enhance financial markets, boost competition among banks and financial institutions, improve the efficiency of credit markets, and facilitate quicker adjustments of lending and deposit rates can strengthen the transmission of policy rates to the wider economy. A stronger monetary transmission would imply that changes in the policy rate would have a bigger impact on borrowing costs, consumption, investment and aggregate demand. This would make monetary policy more responsive to the current inflationary pressures and cut down on unnecessary lags in the transmission process.

19.4 Build advanced analytics skills in high-frequency environments

The Reserve Bank should improve its analytical and forecasting capabilities by refining nowcasting models and developing a broader array of high-frequency inflation indicators. Conventional inflation statistics are often published with a lag, which means that policymakers cannot react quickly to rapidly changing economic circumstances. The systematic use of high-frequency data on food prices, gasoline prices, transportation, commodity prices, consumer demand, and other economic activity can provide more timely indicators of potential inflationary pressures to policymakers. This enhancement of these analytical skills will lead to an improvement in the speed, accuracy and effectiveness of monetary policy decisions.

19.5 Fiscal and Monetary Dynamics in Harmony

Good cooperation between fiscal and monetary authorities is essential for macroeconomic stability. During periods of high inflation, sizable fiscal measures, particularly through widespread subsidy schemes or demand-raising spending, can offset the contractionary effects of monetary policy and bolster aggregate demand. Such interactions may complicate the conduct of inflation management and extend the adjustment process. The RBI and the Ministry of Finance can work more closely to align fiscal and monetary policy with the present macro-economic situation. "The fiscal policy should be well-targeted to the at-risk groups and should not create undue demand-side pressures."

19.6 Reduced Dependence on Imported Energy

It might be a good way to improve long-term inflation stability in India to become less dependent on external sources of energy. Global crude oil and energy prices influence local fuel prices directly and indirectly depending on the local fuel market, and indirectly on transportation, electricity, manufacturing, agriculture and the costs of other commodities and services. Encourage the transition to renewable energy, improve energy-efficiency standards, diversify energy sources, and strengthen regulation of the strategic petroleum reserve to reduce the economy's vulnerability to fluctuations in global oil prices. That would lead to more domestic energy resilience, insulating domestic inflation from fluctuations in global commodity prices.

19.7 Improve Communication Skills

Clear, methodical and open communication by the central bank is a key instrument for improving the credibility of monetary policy. Transparent communication by the RBI about its assessment of inflationary conditions, the drivers of inflation, the expected policy actions and the expected future trajectory of inflation can help households, businesses, investors and financial markets to form more stable expectations. Good communication reduces uncertainty about the choices of monetary policy and improves the public understanding of the inflation-targeting regime. So, communication should be at the heart of the RBI's integrated approach to anchoring inflation expectations.

19.8 Assistance to Vulnerable Households

Higher prices affect people in different ways, and approaches to combating inflation must consider the impact of inflation on low-income and economically disadvantaged families. Targeted and short-term financial assistance can offer considerable

protection to vulnerable populations without generating general demand inflation in times of major increases in the prices of food and essential goods. Such targeted support is generally preferable to broad price controls that can cause market distortions, shortages, or financial strain, or too much monetary easing that could extend inflationary pressures. A strong policy is needed, combining credible inflation management and targeted social protection measures to safeguard the well-being of households.

20. Conclusion

This article examines the linkages between monetary policy and inflation management in India under the flexible inflation targeting framework. The study has used secondary data for the period 2015-16 to 2023-24 and institutional insights from RBI and international organizations. The results indicate that in India, the MPC and the 4% CPI objective have offered a more formal and credible monetary policy framework with a clear nominal anchor. The inflation path for the period under study shows a first phase of moderation, a pandemic-related spike, a peak in 2022-23 and a subsequent phase of disinflation. The RBI's structural econometric evaluations and theory of transmission lags are consistent with the decline in inflation in 2023-24 following the 250 basis points tightening phase of the Reserve Bank of India in 2022-23. The relationship between inflation and annual rates is currently not significant, but that does not mean that monetary policy does not work. But it does show the danger of just using simple correlation analysis in the presence of endogenous policy responses, complex lag patterns and autonomous supply shocks. The main finding is that monetary policy is necessary but not sufficient for inflation control in India. RBI can influence aggregate demand, financial conditions, allocation of credit, liquidity and expectations. But to keep prices steady, more action on the supply side is needed. Therefore, India's inflation management strategy should be multi-pronged and focus on credible inflation targeting, agricultural growth, robust supply chains, energy transition, fiscal discipline, effective monetary transmission and communication. This is consistent with earlier assessments by the IMF that highlight the contribution of India's FIT framework to macroeconomic stability but also the need for further structural changes. The Indian experience shows that changes in the policy rate alone are not enough for effective inflation management.

References

1. Bernanke, B. S., & Gertler, M. (1995). Inside the black box: The credit channel of monetary policy transmission. *Journal of Economic Perspectives*, 9(4), 27-48. <https://doi.org/10.1257/jep.9.4.27>
2. Clarida, R., Galí, J., & Gertler, M. (1999). The science of monetary policy: A New Keynesian perspective. *Journal of Economic Literature*, 37(4), 1661-1707. <https://doi.org/10.1257/jel.37.4.1661>
3. International Monetary Fund. (2025). *India: 2024 Article IV consultation Press release; staff report; and statement by the executive director for India* (IMF Staff Country Report No. 2025/054). <https://doi.org/10.5089/9798229002899.002>
4. International Monetary Fund. (2025). *India: 2025 Article IV consultation Press release; staff report; and statement by the executive director for India* (IMF Staff Country Report No. 2025/314). <https://doi.org/10.5089/9798229030809.002>
5. Mishkin, F. S. (2007). *The economics of money, banking, and financial markets* (8th ed.). Pearson.
6. Ministry of Statistics and Programme Implementation. (2025). *Consumer Price Index (CPI)*. Government of India. <https://www.mospi.gov.in/web/cpi>
7. Reserve Bank of India. (2023). *Annual report 2022-23*. <https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx>
8. Reserve Bank of India. (2024). *Annual report 2023-24*. <https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx>
9. Reserve Bank of India. (2024). *Consumer Price Index Annual average* [Database]. Database on Indian Economy. <https://dbie.rbi.org.in>
10. Reserve Bank of India. (2024). *Monetary Policy Report*. <https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=22068>
11. Reserve Bank of India. (2025). *Annual report 2024-25*. <https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx>
12. Reserve Bank of India. (2025). *Database on Indian Economy*. <https://dbie.rbi.org.in>
13. Taylor, J. B. (1993). Discretion versus policy rules in practice. *Carnegie-Rochester Conference Series on Public Policy*, 39, 195-214. [https://doi.org/10.1016/0167-2231\(93\)90009-L](https://doi.org/10.1016/0167-2231(93)90009-L)
14. Woodford, M. (2003). *Interest and prices: Foundations of a theory of monetary policy*. Princeton University Press.
15. World Bank. (2025). *World development indicators*. <https://databank.worldbank.org/source/world-development-indicators>